



GOVERNMENT OF THE DISTRICT OF COLUMBIA

Independent Auditors' Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards*

September 30, 2012



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To the Mayor and the Council of the Government of the District of Columbia
Inspector General of the Government of the District of Columbia

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, the budgetary comparison statement, each major fund, and the aggregate remaining fund information of the District of Columbia (the District) as of and for the year ended September 30, 2012, which collectively comprise the District's basic financial statements and have issued our report thereon dated January 28, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of the District of Columbia Water and Sewer Authority and District of Columbia Housing Financing Agency, discretely presented component units of the District, were not audited in accordance with *Government Auditing Standards*.

Internal Control over Financial Reporting

Management of the District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.



Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies and that are described in Appendix A to this report. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in finding 2012-02 in Appendix A to this report.

We noted certain matters that will be reported to management of the District in a separate letter.

The District's written responses to the significant deficiencies and instances of noncompliance identified in our audit are described in Appendix A. We did not audit the District's responses and, accordingly, we express no opinion on the responses.

Appendix B presents the status of prior year significant deficiencies and instances of noncompliance.

This report is intended solely for the information and use of the Mayor, the Council, the Office of the Inspector General, District management, the U.S. Government Accountability Office, the U.S. Congress, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 28, 2013

Appendix A – Significant Deficiencies in Internal Control Over Financial Reporting

Finding 2012-01 – Weaknesses in the District’s General Information Technology Controls

Background:

General Information Technology Controls (GITCs) provide the foundation for a well-controlled technology environment that supports the consistent processing and reporting of operational and financial data in accordance with management’s directives. Our audit included an assessment of selected GITCs in four (4) key control areas: Access to Programs and Data, Program Changes, Program Development, and Computer Operations. During our assessment, we noted that, while the District made progress and remediated certain GITC findings identified during our prior year audit, pervasive GITC-related issues continue to exist.

The GITC environment underwent significant transition during fiscal year 2012. The District is currently in the process of modernizing its District-wide System of Accounting and Reporting. As a result, certain deficiencies previously identified will continue to exist, as they will not be remediated until the new system is implemented. Additionally, the District has already remediated other GITC deficiencies during fiscal year 2012. However, as these remediation efforts did not take place until fiscal year 2012 was well under way, the conditions continued to exist during part of the fiscal year and thus are included in this year’s report.

Our fiscal year 2012 findings included the following:

Access to Programs and Data

Conditions:

1. Failure to consistently restrict privileged and general user access to key financial applications in accordance with employee job responsibilities or segregation of duties considerations.
2. Inconsistent performance and documentation of both physical and logical user access administration activities, including the approval of new user access and access changes, periodic review of user access rights, including whether user access is commensurate with job responsibilities, and timely removal of user access upon employee termination.
3. Use of generic accounts to perform system administration or end user functions within key applications without adequate monitoring controls over such activities.
4. Failure to update the policy that defines the minimum password configuration requirements for the District’s Information Technology (IT) systems in approximately seven years. Further, inquiry and inspection procedures performed indicate that the policy was not effectively communicated to responsible personnel. Specifically, we determined:
 - a. The Office of the Chief Technology Officer (OCTO) Password Management Policy, last revised in November 2004, does not require that systems be configured to

automatically lock out user accounts after a predefined number of invalid log-on attempts.

- b. There were various inconsistencies between the requirements outlined in the OCTO Password Management Policy and configurations set within certain applications and their supporting databases and operating systems.
- c. There is potentially confusing language around the scope of the policy, which indicates it is to include “all District Government agencies and all users of DC Government computing equipment” when, in fact, the Office of the Chief Financial Officer (OCFO) is not under the direction of this policy.

As this was a finding in both FY2010 and FY2011, OCTO management implemented a revised Password Management Policy, effective August 31, 2012, which included a requirement for account lockout settings and clearly defines the scope of the policy in remediation of the issues noted above. However, a deficiency in the control environment existed for the period during the year under audit of October 1, 2011 through August 31, 2012.

Program Changes Conditions:

- 1. Failure to institute well-designed program change policies that establish procedural and documentation requirements for authorizing, developing, testing, and approving changes to key financial applications and related infrastructure software¹ in the production environment.
- 2. Inconsistent adherence to established program change management procedures, including instances in which changes made to the system were not approved, tested or documented appropriately per the established procedures.
- 3. Failure to consistently restrict developer access to the production environments of key financial applications in accordance with segregation of duties considerations or, if not feasible, implement independent monitoring controls to help ensure changes applied to the production environment are authorized.

Program Development Conditions²:

¹ Infrastructure changes refer to software changes and updates applied to underlying operating systems and databases supporting the key financial applications.

² Systems Development findings are specific to the Banner application at the University of the District of Columbia in FY 2012.

1. Failure to consistently follow and provide documentation for system development life cycle policies for authorizing, developing, testing, and approving system developments to key financial systems. KPMG noted that formal testing and approval documentation was maintained during FY2012 to support the testing and approval for production migration of program changes; however, the prior year finding (FY2011) was determined to be only partially remediated because the following conditions still existed at the time of our audit:
 - Policies and procedures related to generic account management originally defined by management during FY2012 did not include requirements for logging and monitoring of actions taken under generic accounts. As a result, a series of generic accounts with the ability make changes, including 9 at the database layer, 19 at the operating system layer, and 33 at the application layer, held active access to the environment through FY2012. Of these accounts, a subset were tied to system processes and not procedurally logged into by end users while others were no longer necessary to exist within the environment.
 - While a complete list of patches applied to the application could be provided, changes impacting the functionality of the application made directly through the database during the period could not be produced in order to assess effectiveness of program change controls.
2. Failure to consistently restrict developer access to the production environments of key financial applications in accordance with segregation of duties considerations or, if not feasible, implement independent monitoring controls to help ensure changes applied to the production environment are authorized.

As part of our review in FY2012, Management implemented a policy requiring that the individual responsible for developing the change would not be the same individual responsible for migrating the change; however, the two developers with access to production remain able to circumvent this policy without detective controls to identify if such instances were to occur.

3. Usage of generic accounts during the implementation to apply changes to the application, operating system, and underlying database with no evidence of monitoring of these generic accounts.

As part of our assessment for FY2012, KPMG determined that new policies and procedures were implemented to:

- Govern the use of generic accounts within the environment only when absolutely necessary to support a business or application function, and
- Govern the change management process and the nature and extent of testing and approvals to be documented for program changes made to the application.

Computer Operations Conditions:

1. Failure to establish a monitoring process for identifying and addressing production job failures in several systems.

2. Failure to retain system-generated documentation from the scheduling and processing utility to evidence the completion status of system jobs scheduled through the applications' utilities.
3. Failure to perform official testing to confirm that several system backup tapes can be successfully recovered and restored.

The table below summarizes the key financial applications that were impacted by the findings noted above.

Table 1: Summary of Applications Impacted by the Findings

GITC Area	Access to Programs and Data			Program Changes			Computer Operations		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
Central and Overarching Applications									
Automated Claims Eligibility Determination System (ACEDS)	Red	Yellow	Yellow	Red	Yellow	Yellow	Gray	Gray	Gray
Computer-Assisted Mass Appraisal System (CAMA)	Gray	Gray	Red	Gray	Gray	Red	Gray	Gray	Yellow
iNovah	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Green	Green	Green
PeopleSoft	Red	Yellow	Yellow	Red	Yellow	Yellow	Gray	Gray	Gray
Procurement Automated Support System (PASS)	Red	Yellow	Yellow	Yellow	Yellow	Yellow	Gray	Gray	Gray
System of Accounting and Reporting (SOAR)	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Green	Green	Green
Time, Attendance, and Court Information System (TACIS)	Red	Yellow	Yellow	Red	Yellow	Yellow	Gray	Gray	Gray
Tax Administration System (TAS)	Red	Yellow	Yellow	Yellow	Yellow	Green	Yellow	Yellow	Green
Department of Employment Services									
Budget and Reporting Tracking System (BARTS)	Red	Green	Yellow	Yellow	Green	Yellow	Green	Green	Green
District Online Compensation System (DOCS)	Red	Yellow	Yellow	Red	Yellow	Yellow	Green	Yellow	Green
District Unemployment Tax Administration System	Red	Yellow	Yellow	Red	Yellow	Red	Green	Yellow	Green
United Medical Center									
Meditech Health Care Information System (HCIS)	Red	Yellow	Red	Green	Red	Green	Red	Green	Gray
University of the District of Columbia									
Banner	Gray	Red	Red	Gray	Red	Red	Gray	Gray	Gray

Application In-Scope	
Red	Objective Deemed Ineffective
Yellow	Findings Noted But Objective Deemed Effective
Green	No Findings Noted in Area
Gray	Area Not Fully Tested

Application Not In-Scope	
Red	New Findings Identified
Yellow	PY NFRs Remain
Green	All PY NFRs Remediated

Criteria:

1. The Federal Information Security Management Act (FISMA), passed as part of the Electronic Government Act of 2002, mandates that Federal entities maintain IT security programs in accordance with National Institute of Standards and Technology (NIST). The following NIST criteria were considered:
 - a. NIST SP 800-12, An Introduction to Computer Security: The NIST Handbook, October 1995;
 - b. NIST SP 800-53, Revision 3, Recommended Security Controls for Federal Information Systems and Organizations, August 2009;
 - c. NIST SP 800-64, Security Considerations in the System Development Life Cycle, October 2008; and
 - d. NIST SP 800-14, Generally Accepted Principles and Practices for Securing Information Technology, September 1996.
2. The Information Systems Audit Control Association (ISACA) Control Objectives for Information and related Technology (COBIT®) 4.1, 2007.

Cause/Effect:

The findings highlighted above include weaknesses in both the design and operating effectiveness of controls considered relevant to the access to programs and data, program changes, program development, and computer operations areas. Although management has made progress remediating previous findings, additional improvements in formalizing key GITC processes and creating an effective monitoring function are needed. The existence of these findings increases the risk that unauthorized changes applied to key financial applications and the data they process adversely affect application processing and data integrity and, as a result, may impact the financial statements. Additionally, the existence of these findings impacts the reliability of key application reports and the ability to rely upon automated, configurable controls embedded within key financial applications.

Recommendations:

We noted that management did remediate several control deficiencies from the prior year. There were 36 NFRs documented in FY2011. Of them:

- 10 represented findings that had been remediated during FY2011 (as part of remediation efforts for FY2010 NFRs);
- 8 were remediated during FY2012; and,
- 9 were partially remediated during FY2012.

We recommend that management continue to perform the remediated control activities put in place. Further, we recommend that management monitor the effectiveness of these controls on a regular and periodic basis going-forward.

To the extent the following findings are not remediated, we recommend the following:

1. Related to Access to Programs and Data controls, we recommend that management:
 - a. Assess and update or, as applicable, develop and document access management policies and procedures for production applications and underlying infrastructure systems. These policies and procedures should address requirements for clearly documenting user access requests and supervisory authorizations, periodic reviews of the appropriateness of user access by agency business management, timely communication of employee separations/transfers, and disablement/removal of the related user access. Management should formally communicate policies and procedures to control owners and performers. Further, management should institute a formalized process to monitor adherence to policies and procedures related to key controls and, as performance deviations are identified, follow up as appropriate.
 - b. Develop and implement controls that establish organizational and logical segregation between program development roles, production administration roles, and business end user roles among different individuals or, independently performed monitoring of the activities of users provided with conflicting system access over the activities of the developers (and other individuals) with administrative access that require the documentation of monitoring activities as well as follow up on any suspicious behavior within the system.
 - c. Restrict the use of generic IDs or, if such access is required, implement independent monitoring of the activities performed using generic IDs.
 - d. Develop and formally document the physical access management policy and procedures for all server rooms. We recommend that these include, at a minimum, procedural and documentary requirements for:
 - i. Requesting and approving physical access;
 - ii. Timely disablement/removal of physical access rights during instances of employee separations; and
 - iii. Performing periodic reviews of access in consideration of users' ongoing need to retain physical access, and the modification of any updates required as a result of inappropriate access identified during the review process.
2. Related to Program Change controls, we recommend that management:
 - a. Develop and implement change management processes and controls that establish one or more of the following:
 - i. Organizational and logical segregation of program development roles from production system and database administration roles among different individuals; and

- ii. Implementation of one or more independently operated monitoring controls over the activities of the developers (and other individuals) with administrative access that require the documentation of monitoring activities as well as follow up on any suspicious behavior within the system. Documentation of these monitoring controls should be maintained and include sign-off of the review as well as notations as to the appropriateness of the actions taken by the developers within the database. Further, any suspicious activity, such as modifications to functionality or data without corresponding change request approvals, should be followed-up upon, as necessary.
 - iii. Additionally, management should continue to document the performance of User Acceptance Testing (UAT).
 - b. Configure settings or implement monitoring tools to log changes made to application functionality, including all configuration changes.
- 3. Related to Program Development Controls, we recommend that management:
 - a. Develop and implement program development processes and controls that establish one or more of the following:
 - i. An evaluation of the generic accounts that exist and documentation of the purpose of each generic account required to remain active, if any. Furthermore, for generic accounts that are required to remain active, we recommend management implement a formal process to approve and document each access request to generic accounts and perform a documented periodic review of generic account activity.
 - ii. The implementation of procedural and documentary requirements for:
 - Recording the nature of each change being applied;
 - Evaluating the impact and risk of each change relative to objective rating criteria;
 - Approving (and documenting such approvals of) changes; and
 - Validating the functionality/system impact of each change via pre-production testing in a model environment.
- 4. Related to Computer Operations controls, we recommend that management:
 - a. Implement any required changes to support an extended retention of job processing logs in support of audit requirements. Additionally, we recommend that management continue to save daily Excel reports produced by systems to limit the impact of any future archival issues.
 - b. Document the completion of the new process put in place to monitor open application incidents reported to the OCFO Help Desk that are forwarded to the TSG, and also to ensure that they are remediated within a defined time period that is acceptable to application owners.
 - c. Implement policies and procedures to ensure that backup tapes are officially tested on a semi-annual basis to confirm successful recovery and restoration of data.

These procedures should be provided to and discussed with the personnel responsible for enforcing the control activity. Further, management should monitor the personnel responsible for enforcing the control activity periodically.

Management Response:

The District concurs with the auditor's findings and agrees that there are weaknesses in its general information technology controls. Over the last several years, the District has engaged in an extensive remediation process to address and resolve the reported findings and to strengthen internal controls related to information technology. While much improvement has been made as a result of that effort, we recognize that there are areas in which improvement is still needed. Therefore, the District will continue its remediation activities and will, as part of that process, incorporate the recommendations made by the auditor as we work to improve controls related to: Access to Programs and Data, Program Changes, Program Development, and Computer Operations.

Finding 2012-02 – Weaknesses in the District's Procurement and Disbursement Controls and Non-compliance with Laws and Regulations

Conditions:

During our FY 2012 testwork, we noted that in order to be as efficient and effective as possible, the District has established District-wide policies and procedures to procure goods and services and to make payments for those goods and services at the Office of Contracts and Procurement (OCP), as well as at those agencies that have independent procurement authority. Further, these policies and procedures serve to ensure the District's compliance with various laws and regulations governing procurements and payments, such as the Procurement Practices Act and the Quick Payment Act.

OCP has implemented a comprehensive, multi-year remediation plan to address previously identified deficiencies and has completed the steps scheduled for FY 2012. While these remediation efforts resulted in improvements within the Procurement process, we still noted deficiencies that continue to be repeated from previous years during FY 2012. Specifically, we noted the following:

For our sample of sole-source procurements we noted:

- a. For 10 of 38 sole source procurements, we noted that there was not sufficient documentation to validate the sole source method was justified.
- b. For 1 of 38 sole source procurements tested, the Council approval was not available for review.
- c. For 1 of 38 sole source procurements, the Determination and Findings was not available for review.

- d. For 1 of 38 sole source procurements, the purchase order amount is greater than the contract amount by \$150,000.
- e. For 1 of 38 sole source procurements, the contract did not cover the period of the purchase order.

Pursuant to Section 201 (b) of the PPRA, the Department of General Services (DGS) is an Independent Agency and is authorized to exercise procurement authority to carry out its procurement independent of the Office of Contracting and Procurement (OCP). However, these procurements are still classified under OCP in the general ledger and as such were included in our testing. Of the 38 sole-source procurements tested, 2 of them related to DGS. Of the 2 we noted the following:

- a. For 1 of 2 sole source procurements, the procurement file was not available for review.
- b. For 1 of 2 sole source procurements, the contractor's delegation of authority was not available for review.

For our sample of emergency procurements tested, we noted:

- a. For 5 of 13 emergency procurements we noted that there was not sufficient documentation to validate the emergency procurement method was justified.
- b. For 1 of 13 emergency procurements, the determination and finding (D&F) was not made available for review.
- c. For 3 of 13 emergency procurements, the period of performance exceeded the 120 day maximum duration requirement for an emergency procurement.

Pursuant to Section 201 (b) of the PPRA, the Department of General Services (DGS) is authorized to exercise procurement authority to carry out its procurement independent of OCP. However, these procurements are still classified under OCP in the general ledger and as such were included in our testing. Of the 13 procurements tested, we noted 1 of them related to DGS. Specifically, we noted:

- a. For the 1 DGS emergency procurement, the contracting officer's delegation of authority was not available for review.

For our sample over competitive procurements executed during the year:

- a. For 30 of 131 competitive procurements, there was no evidence that the procurement went through the competitive process.
- b. For 2 of 131 competitive procurements, the Council approval was not available for review.
- c. For 15 of 131 competitive procurements, the evidence of the excluded party list was not available for review.

- d. For 1 of 131 competitive procurements, evidence of the contractor compliance with the District tax code was not available for review.
- e. For 1 of 131 competitive procurements, there were insufficient quotes available for review for small purchases.
- f. For 1 of 131 competitive procurements, the contract was missing the authorizing signature.
- g. For 2 of 131 competitive procurements, the contract was not available for review.
- h. For 1 of 131 competitive procurements, the contract was not available for review.

As noted in DC ST 7-3005.01, we noted that the Director of the Department of Health is authorized to exercise procurement authority to carry out its procurement independent of OCP. However, these procurements are still classified under OCP in the general ledger and as such were included in our testing. Of the 131 competitive procurements tested, we noted 9 of them related to Human Care Contracts. Of these 9 we noted the following:

- a. For 7 of 9 agreements, the determination and finding was not available for review.
- b. For 3 of 9 agreements, the period of performance noted in the agreement did not cover the period being audited.
- c. For 1 of 9 agreements, the agreement was not available for review.
- d. For 1 of 9 agreements, the Attorney General legal review/approval was not available for review.
- e. For 2 of 9 agreements, evidence of the excluded party list was not available for review.
- f. For 4 of 9 agreements, evidence of the contractor compliance with the District tax code was not available for review.

Pursuant to Section 201 (b) of the PPRA, the Department of General Services (DGS) is authorized to exercise procurement authority to carry out its procurement independent of OCP. However, these procurements are still classified under OCP in the general ledger and as such were included in our testing. Of the 131 competitive procurements tested, we noted 2 of them related to DGS. Specifically we noted:

- a. For 2 of 2 competitive procurements, there were insufficient quotes available for review for the small purchases.

During our testing over the District's three Independent Agency's procurement transactions, we tested over 100 procurements and noted exceptions related to the Department of General Services (DGS) and Office of the Chief Financial Officer. Specifically, we noted the following:

For sole-source procurements, we noted that:

- a. For 6 of 25 sole source procurements, there was no delegation of authority available for review. All 6 exceptions related to the Department of General Services.
- b. For 2 of 25 sole source procurements, all relating to the Department of General Services, the contract was not available for review.
- c. For 2 of 25 sole source procurements, all relating to the Department of General Services, there was no evidence of compliance with the District's tax code.
- d. For 2 of 25 sole source procurements, the method for use of sole-source procurement was not justified. Both exceptions related to the Office of the Chief Financial Officer.

For emergency procurements we noted that:

- a. For 16 of 16 DGS emergency procurements, the contracting officer's delegation authority was not available for review.
- b. For 6 of 16 DGS emergency procurements, the length of procurement is greater than 90 days.
- c. For 3 of 16 DGS emergency procurements, there is no evidence as to whether the Agency verified whether or not the vendor was suspended or debarred.
- d. For 3 of 16 DGS emergency procurements, there is no evidence of compliance with the District's tax code.

For competitive procurements we noted that:

- a. For 78 of 78 DGS competitive procurements, the contracting officer's delegation of authority was not available for review.
- b. For 2 of 78 DGS competitive procurements, the legal sufficiency reviews were not available for review.
- c. For 9 of 78 DGS competitive procurements, the evidence to support that the procurement went through a competitive process were not available for review.
- d. For 8 of 78 DGS competitive procurements, the number of quotes available for review was not sufficient per DGS policy.

- e. For 4 of 78 DGS competitive procurements, the evidence supporting that the search for the excluded and debarred was performed was not available for review.
- f. For 8 of 78 DGS competitive procurements, the signed contract document was not available for review.
- g. For 4 of 78 DGS competitive procurements, the evidence supporting that the vendor was compliant with the District tax compliance was not available for review.

During our testing over purchase card (P-card) transactions and monthly P-card statement reconciliations, we noted the following deficiencies:

- a. For 22 of the monthly reconciliations totaling \$3,304,205 of the 36 monthly reconciliations tested totaling \$4,349,614, we noted that the reconciliations were not reviewed and approved by the approving official in a timely manner in accordance with OCP Policy No.2009-01. Of the 22 exceptions we noted the following Agencies did not comply with the policy:
 - Fire and Emergency Medical Services (7)
 - Metropolitan Police Department (3)
 - Office of Tenant Advocate (3)
 - Office of the Mayor (4)
 - Office of the Secretary (1)
 - DC Public Library 1)
 - Office of Contracting & Procurement (3)
- b. For 5 individual transactions totaling \$15,090 out of 40 transactions tested totaling \$252,456, there was not sufficient documentation to support the purchase or validate that it was for an approved transaction. All 5 exceptions were from the Office of Tenant Advocate.
- c. For 2 individual transactions totaling \$11,850 out of 40 transactions tested totaling \$252,456, we noted that the authorizer approved purchases exceeding the \$2,500 single and \$10,000 cycle transaction limit, these exceptions related to the Office of the Mayor and the Metropolitan Police Department.
- d. For 3 monthly statements totaling \$134,343 of 36 monthly statements totaling \$4,349,614, we noted that 2 cardholders exceeded their approved cycle limit for the months reviewed. These exceptions related to Fire and Emergency Services and the Office of Tenant Advocate.
- e. For 1 transaction totaling \$100,411 out of 40 transactions tested totaling \$252,456, the cardholder exceeded the small purchase limit of \$100,000 per PPRA Sec. 407 small purchase procurements. This exception related to the Office of Contracting and Procurement.

In our testing of procurement and disbursement transactions at the District of Columbia Public Schools (DCPS), we noted the following:

- a. For 3 of 180 purchase order files for payments totaling \$13,673, the files did not originally include a search for federal debarment. DCPS subsequently provided a note stating that the system was down on that day, but since the document was not originally in the file, we cannot verify that a search was performed during the procurement process.
- b. For 1 of 64 contract files for a payment totaling \$11,492, the file did not include the required Determination and Findings.
- c. For 1 purchase order and contract file for payment totaling \$382, the purchase order file and contract file was not provided by DCPS.

In our testing of compliance with the District of Columbia Quick Payment Act, we noted that:

- a. 1 of 67 District payments (i.e. non-DCPS) selected for testing were not paid timely in accordance with the Quick Payment Act.
- b. 100 of 426 DCPS payments selected for testing were not paid timely in accordance with the Quick Payment Act.

Criteria:

The Procurement Practices Act indicates the following:

27 DCMR chapter 17, states that: *“In each instance where the sole source procurement procedures are used, the contracting officer shall prepare a written determination and findings (“D&F”) justifying the procurement which specifically demonstrates that procurement by competitive sealed bids or competitive sealed proposals is not required.”*

27 DCMR chapter 17, states that: *“Each sole source D&F for a procurement in an amount greater than twenty-five thousand dollars (\$25,000) shall be reviewed by the Director before solicitation and shall be approved by the Director before contract execution.”*

DC Code 1-204.51, states that: *“prior to the award of a multiyear contract or a contract in excess of \$1,000,000 during a 12-month period, the Mayor or executive independent agency or instrumentality shall submit the proposed contract to the Council for review and approval.”*

DCMR chapter 17 states that *“An “emergency condition” is a situation (such as a flood, epidemic, riot, equipment failure, or other reason set forth in a proclamation issued by the Mayor) which creates an immediate threat to the public health, welfare, or safety. The emergency procurement of services shall be limited to a period of not more than one hundred twenty (120) days. If a long-term requirement for the supplies, services, or construction is anticipated, the contracting officer shall initiate a separate non-emergency procurement action at the same time that the emergency procurement is made. The contracting officer shall attempt to solicit offers or proposals from as many potential contractors as possible under the emergency condition. An emergency procurement shall not be made on a sole source basis unless the emergency D&F includes justification for the sole source procurement. When an emergency*

procurement is proposed, the contracting officer shall prepare a written determination and findings (D&F) that sets forth the justification for the emergency procurement.”

Financial Management and Control Order 07-004A states that *“Direct Voucher payment requests that are not explicitly identified in Financial Management and Control Order 07-004A, shall be submitted to the Deputy Chief Financial Officer for the Office of Financial Operations and Systems (OFOS) for consideration and approval in accordance with policy and procedures set forth for direct voucher payment review and consideration by OFOS.”*

According to the District Purchase Card program policies and procedures:

- **Purchase limit:** An individual who is issued a P-Card under the DC Purchase Card Program shall use the purchase card to buy commercially available goods and services, for *Official Government Business only*, with a value that does not exceed \$2,500 per single transaction and a total amount of \$2,500 per card per day and \$10,000 per card account per monthly cycle, **unless otherwise specified by the Chief Procurement Officer in the delegation of contracting authority.**
- **Reconciliation:** Each approving official will have a queue of all P-card statements waiting for them in the PaymentNet system. By the 27th of each month, the Approving Official should obtain original receipts from cardholders under their jurisdiction and ensures that the cardholders have reviewed all transactions in PaymentNet. The Approving Official should review each transaction to verify that the good or service were received, that the nature of the purchase was within programmatic guidelines, and that the receipts match the amount listed in PaymentNet. The Approving Official should mark each transaction as Approved in PaymentNet **by the 3rd day of the subsequent month.**

According to **DC Code 1-204.51**, *“prior to the award of a multiyear contract or a contract in excess of \$1,000,000 during a 12-month period, the Mayor or executive independent agency or instrumentality shall submit the proposed contract to the Council for review and approval”*

Also, **DC Code 2-301.05(G)** states that *“All contracts over a million dollars must go to the Office of the Attorney General (OAG) for a legal sufficiency review.”*

27 DCMR chapter 15

1511.3 Prospective bidders that have been debarred or suspended from District contracts or otherwise determined to be ineligible to receive awards shall be removed from solicitation mailing lists to the extent required by the debarment, suspension, or other determination of ineligibility

The requirements for allowable costs/cost principles are contained in the A-102 Common Rule (§___.22), OMB Circular A-110 (2 CFR section 215.27), OMB Circular A-87, “Cost Principles for State, Local, and Indian Tribal Governments” (2 CFR part 225), program legislation, Federal awarding agency regulations, and the terms and conditions of the grant award. Management is required to maintain adequate internal controls to prevent and detect instances of noncompliance.

The District's Quick Payment Act indicates the following: *If a contract specifies the date on which payment is due, the required payment date is the date specified in the contract. If a contract does not specify a payment date, the required payment date will be one of the following:*

- (a) Meat and meat food products - the seventh (7th) day after the date of delivery of the meat or meat product;*
- (b) Perishable agricultural commodities - the tenth (10th) day after the date of delivery of the perishable agricultural commodity; or*
- (c) All other goods and services - the thirtieth (30th) day after the receipt of a proper invoice by the designated payment officer.*

Cause/Effect:

District agencies are not adhering to the established policies and procedures governing creation and maintenance of procurement documentation and the payment of vendor obligations, which may cause noncompliance with the Procurement Practices Act and the Quick Payment Act. Additionally, internal controls need to be improved to ensure compliance with all procurement laws and regulations.

Recommendation:

We recommend that the District continue to strengthen its internal controls over procurement through the implementation of its deficiency remediation plan. These implementation efforts should continue to be led by the OCP Procurement Integrity and Compliance Office (PICO), and sufficient resources should be provided to this office to ensure it can successfully implement the remediation plan. The performance measurement statistics monitored by PICO should be provided to both the Mayor and the Chief Financial Officer at least semi-annually so that senior District management is apprised of progress on the remediation plan.

Management Response:

Consistent with the Independent Auditor's view of measurable improvements in procurement practices at the Office of Contracting and Procurement (OCP), for the fifth consecutive year, OCP recorded a year-to-year decline (**7%**) in its total number of audit findings. While one audit finding is *one too many*, this administration is encouraged by data showing a sustained reduction in the *prevalence* and *severity* of noncompliance issues across the many thousands of requisitions processed yearly by OCP's procurement staff.

As noted by the Independent Auditor, a considerable number of audit findings were from contracts awarded in prior years. In fact, a review of the audit sample shows that contracts awarded before calendar year (CY) 2011 (**58 percent** of deficient contracts) accounted for **70 percent** of OCP's FY 2012 audit findings.

The Independent Auditor also cited several instances where Sole Source and Emergency Procurements were "not justified". While it might appear that OCP did not comply with established regulations, the root cause for selecting the sole source and emergency procurement methods was to avoid disruptions to critical government operations. The regulations allow for

this, and to the extent that this was a factor, it should be viewed that affected contracting officers were reasonably exercising their professional judgment.

What is at issue here is when the emergency or sole source methods are repeatedly exercised, with the same vendor, over an extended period. This scenario is not unique to OCP and highlights the concern around the effectiveness of procurement planning in general, and how poor planning could hinder competitive practices, give the appearance of unfair advantages to select vendors, or result in missed opportunities to obtain the best value and price for services rendered beyond the final option year of a contract.

The Independent Auditor noted the shared responsibility of acquisition planning efforts. The District agrees with this assessment and will take measures to foster collaboration between agencies and their respective contracting offices to improve the procurement process – with regards to forecasting and fulfilling needs - and to better mitigate associated risks.

Finally, OCP has been responsive to the Independent Auditor's recommendation in the FY 2011 Yellow Book Report to continue to implement, monitor, and report on the results of its deficiency remediation plan to both the Mayor and the Chief Financial Officer. In FY 2012, OCP's Office of Procurement Integrity and Compliance (OCP-OPIC) coordinated District-wide remediation activities, and performed limited testing of transactions at 8 independent agencies cited in the prior year report.

As noted in last year's management response, although the percentage share of OCP's CAFR deficiencies was down (**41%** in FY11 as compared to **68%** in FY10), District-wide totals were trending upwards, requiring cooperation between OCP and independent agencies. Consequently, the objectives of OCP-OPIC activities were to raise awareness, and provide those charged with governance the data needed to make operational adjustments as needed.

This year's results are no different. OCP's share of District-wide deficiencies has fallen (**29%** in FY 2012 as compared to **41%** in FY 2011); while the total number of procurement audit findings for the District has risen. Coordination of remediation actions and the sharing of best practices must continue to improve results across the entire procurement continuum.

Finding 2012-03- Weaknesses in the District's Internal Controls Surrounding Tax Revenue Accounting and Reporting

Conditions:

During our testing over the District's Tax Revenue, which is under the jurisdiction of the Office of Tax and Revenue (OTR), we noted the following:

- a. The Office of Financial Operations and Systems (OFOS) relies upon the District Office of the Attorney General (OAG) to provide estimates of the amounts to be considered for accrual related to all outstanding claims and judgments in the District's financial statements. This review historically only covers those claims and judgments in excess of \$200,000. Individual settlements associated with Superior Court Appeals are usually less

than the \$200,000 threshold used. As a result, most outstanding Superior Court Appeals related to property tax assessments are not being assessed for inclusion in the District's fiscal year end claims and judgment accrual. This resulted in an understatement of the accrual due to property tax assessments of approximately \$58 million as of September 30, 2012. District management subsequently recorded an adjustment to correct for this understatement in its 2012 government-wide financial statements.

- b. OTR records accounts receivables for Sales & Use and Personal Income taxes at the fully realizable amount instead of applying the one-year availability criteria to the balances. This resulted in an understatement of deferred revenue of approximately \$5.5 million and \$17.4 million for Sales & Use and Personal Income taxes, respectively.
- c. OTR's Real Property Tax Administration (RPTA) tracks information related to real property assessment appeals with the exception of those appeals that are remanded to District Superior Court in FoxPro system. RPTA loads FoxPro information into the Integrated Tax System (ITS) through a process whereby RPTA personnel export a database file from FoxPro and upload the file. ITS is programmed to automatically transfer the FoxPro database file from the network folder to ITS. We noted that there is no formal review process in place to check the completeness and accuracy of the information uploaded into ITS from FoxPro.
- d. During our internal control testwork over real property assessment appeals, 2 adjustments out of 40 adjustments tested were not approved by the Chief Assessor as required by the Appeals Divisions policies and procedures.
- e. Monthly reconciliations between certain tax revenue subsidiary records and the general ledger contained un-reconciled differences that were not identified during the supervisory review of the reconciliation. Of 15 reconciliations tested, we noted 2 reconciliations with combined unreconciled differences of \$10,865. In addition, we noted that for 1 of the reconciliations, the supervisory review was not performed timely.

Criteria:

Yellow Book, Appendix I, section A1.08 d., states that management at a State and Local government entity is responsible for *"establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met; following laws and regulations; and ensuring that management and financial information is reliable and properly reported;"*

District of Columbia- Office of the CFO, Policies and Procedures, Section 35303003.40 states that the Refund Control Unit (RCU) of RAA is responsible for *"tracking, reviewing, qualifying, approving, and recording refund disbursement requests. The RCU manager has the overall responsibility for managing the staff and the process related to refund disbursements. The Office of Finance and Treasury (OFT) produces and disburses check and/or direct deposits in response to RAA/RCU requests."*

District of Columbia- Office of the CFO, Policies and Procedures, Section 35301009.40 states that RAA is responsible for *“having the refund reconciliation completed and for journaling all outstanding items that are on the final reconciliation of the quarter.”*

The Assessment Division within the Real Property Tax Administration has established requirements as follows:

- For all changes from the current to proposed (new) Estimated Market Values (EMV) on property between 10% and 39% or between \$1 million and \$4 million, manual approval of the Hearing Officer is required in addition to approval by the Appraiser and Unit Supervisor.
- For changes from the current to proposed (new) EMV on property for amounts that exceed 40% and \$4 million, manual approval of the Chief Assessor is required in addition to approval by the Appraiser, Unit Supervisor, and Hearing Officer.

GASB Statement No. 33 *Accounting and Financial Reporting for Nonexchange Transactions* states that

“When the modified accrual basis of accounting is used, revenues resulting from nonexchange transactions should be recognized as follows: Derived tax revenues. Recipients should recognize revenues in the period when the underlying exchange transaction has occurred and the resources are available.”

The Committee of Sponsoring Organizations of the Treadway Commission- Internal Control Integrated Framework states that, *“The Internal control systems need to be monitored--a process that assesses the quality of the system’s performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the board.”*

Cause/Effect:

Policies, procedures and controls need to be improved to address the noted deficiencies. Failure to address these noted deficiencies could result in misstatements in the fund and government-wide financial statements.

Recommendations:

We recommend that OTR strengthen its policies, procedures and controls to ensure that the above noted deficiencies are addressed.

Management Response:

The Office of Tax and Revenue (OTR) continues to build an internal control program that is based on risk identification and self-assessment, with an awareness of the value of implementing certain controls while delaying the implementation of others.

Management concurs with the reported findings, and will revise procedures and reinforce them with staff as appropriate. For those findings that relate directly to the District's annual financial statements, OTR will make the recommended changes to the accounting treatment to be applied. OTR has already begun to improve the methodology and data used to estimate the government-wide financial statement liability, even though relatively few Superior Court real property tax appeal cases are decided each year outside of those for which the District participates in a settlement agreement. With regard to the treatment of accounts receivable, although OTR has consistently applied the same methodology from year-to-year, it has developed a procedure for determining Sales & Use and Personal Income tax receivables expected to be recognized as deferred revenue.

In October 2012, OTR implemented new processes and controls surrounding the upload of data from FoxPro into the Integrated Tax System and automation to enforce tiered approvals for assessment changes resulting from first level appeals. OTR also implemented an automated tiered approval process within the First Level Appeals Tracking Systems, which significantly reduces the risk that a valuation change could be made without proper authorization.

OTR will reinforce requirements for supervisory review and periodic reconciliation of subsidiary ledgers and tracking systems to SOAR entries to prevent and detect data entry errors.

Finding 2012-04- Weaknesses in the District's Financial Reporting for Capital Assets

Conditions:

During our FY 2012 testwork, we noted that the District does not have uniform, District-wide policies and procedures for the identification of completed capital projects to ensure that projects are transferred from Construction-in-Progress (CIP) to capital assets in service in the period in which the assets are placed in operation consistently across District agencies. We noted that the methods currently used by agencies to account for CIP varies widely throughout the District, which results in a highly decentralized and inconsistently applied capital assets financial reporting process. We also noted that the District does not have a formal procedure in place to monitor CIP balances to ensure timely transfer of costs to capital assets upon project completion. Additionally, a detail of current capital expenditures and costs associated with completed projects transferred to capital assets by project is not available at the Office of Financial Operations and Systems (OFOS), although District agencies transfer CIP based on the completion of a project.

As a result of these deficiencies, during our testwork over a sample of 25 projects totaling approximately \$966 million transferred to CIP during FY 2012, and a sample of 25 projects

totaling approximately \$729 million remaining in CIP at September 30, 2012, we identified the following errors in capital assets and CIP balances:

- a. \$365.4 million reported in CIP as of September 30, 2012 related to projects that were completed in prior fiscal years and should have been transferred to capital assets prior to FY 2012. We also noted that accumulated depreciation for these assets was understated by approximately \$17.8 million, as depreciation should have started accruing in prior years when the related assets were placed in operation. We proposed an audit adjustment to management, who corrected the error in the 2012 governmental activities financial statements.
- b. \$311 million transferred to capital assets in the current year that related to projects completed in prior fiscal years. We noted that accumulated depreciation for these capital assets was understated by approximately \$12.9 million, as depreciation should have started accruing in prior years when the related assets were placed in operation. We proposed an audit adjustment to management, who corrected the error in the 2012 government wide financial statements.
- c. Additionally, we noted that the internal controls in place over the review of Agency submitted Closing Packages, performed by OFOS, are not operating effectively to ensure timely and accurate reporting of District capital asset additions for financial reporting. Specifically, we noted:
 - For 4 of 8 agency Closing Packages, the Closing Package review checklist was signed by the OFOS reviewer prior to the review being completed,
 - For 2 of 7 Agency Closing Packages, Closing Package was prepared and reviewed by the same individual in OFOS,
- d. Of a sample of 42 capital expenditures totaling \$103.8 million, we noted for 2 sample items tested totaling \$7.5 million, supporting documentation for the expenditure was not provided for \$2,322 of the sampled amount.

Criteria:

GASB Statement No. 34 - Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: According to Governmental Accounting Standards Board (GASB) Statement No. 34, paragraph 19, capital assets include land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. In compliance with GASB No. 34, Governments should report all capital assets, including infrastructure assets, in the government-wide statement of net assets and generally should report depreciation expense in the statement of activities.

Cause/Effect:

The District has not developed sufficient policies and procedures to ensure costs transferred from CIP are tracked on a project level and that the amounts transferred are properly supported. Furthermore, the District lacks a complete and formalized capital asset financial reporting policy that includes requirements for proper identification, tracking and recording of capital expenditures and capital asset additions and disposals, including transfers from CIP to fixed assets, to ensure complete and accurate recording of capital assets in the government-wide financial statements.

Without effectively designed and implemented internal controls over the financial reporting process for capital assets, misstatements in capital asset balances may not be prevented or detected in a timely manner.

Recommendations:

We recommend that the District strengthen their internal controls over the financial reporting process for capital assets to ensure that capital asset balances are complete and accurate as of the fiscal year end. This should include the following:

- Implementing a centralized project accounting system that is fully integrated with the general ledger that allows capital asset transactions to be tracked at an invoice and project level.
- Developing District-wide policies and procedures for identifying completed capital projects to ensure that projects are transferred from CIP to capital assets in the period in which the assets are placed in operation.
- Developing District-wide policies and procedures for identifying capital project expenditures that are non-capital in nature and ensuring such expenditures are expensed in the period incurred.
- Providing training to District agencies regarding policies and procedures for determining proper classification of capital expenditures and timely transfer of completed projects to fixed assets to reinforce that such procedures are uniformly applied across the District.
- Reconciliation of agency fixed asset activity to the general ledger on a periodic basis, rather than only at year-end.
- Adherence to existing internal control procedures for the review and approval of agency-reported closing package information to ensure that the closing packages are submitted timely and that the reported capital asset data is complete and accurate.

Management Response:

The District concurs with the findings as noted and will implement measures to mitigate the reported deficiencies. The OCFO's Office of Financial Operations and Systems is in the process of developing policies and procedures for closing out capital projects. It is anticipated that such policies and procedures will be finalized and implemented during fiscal year 2013. To the extent deemed to be necessary, training will also be held to ensure that responsible parties are knowledgeable of the required procedures. Implementation of the procedures for capital projects along with training should result in improved standardization of practices among District agencies. Other measures will be implemented as needed to improve the District's processes for: reconciling agency capital asset activity to the general ledger; and reviewing and approving agencies' capital assets closing packages.

Appendix B – Status of Prior Year Significant Deficiencies in Internal Control Over Financial Reporting

Prior Year Finding #	Prior Year Finding Title	Prior Year Finding Classification	Current Status
2011-01	Weaknesses in the District's General Information Technology Controls related to: -Access to Programs and Data -Program Changes -Program Development -Computer Operations	Significant Deficiency	Repeated as a significant deficiency in fiscal year 2012
2011-02	Weaknesses in the District's Procurement and Disbursement Controls related to: -Lack of supporting Documentation -Inadequate approvals -Non-compliance with emergency criteria -Pcard reconciliations -Quick Payment Act	Significant Deficiency	Repeated as a significant deficiency in fiscal year 2012